

May 6, 2005

**By E-Mail**

David R. Eichenlaub  
Assistant Director, Division of Economics and Finance  
State Corporation Commission  
P.O. Box 1197  
Richmond, Virginia 23218-1197

**Re: State Corporation Commission 2005 Report To Governor Warner And The Commission  
On Electric Utility Restructuring On The Status Of The Development Of Regional  
Competitive Markets And Recommendations To Facilitate Effective Competition In The  
Commonwealth As Soon As Practical**

**Competitive Stakeholders' Comments on the Status of Regional Competitive Markets and  
Recommendations of to Facilitate Effective Competition in Virginia**

Dear Mr. Eichenlaub:

In conjunction with the preparation of the State Corporation Commission's ("Commission" or "SCC") 2004 report ("2004 EURC Report") to Governor Warner and the legislative Commission on Electric Utility Restructuring ("EURC"), an *ad hoc* coalition of retail companies submitted comments on the status of the developments of regional competitive markets, and recommendations to facilitate effective competition in Virginia as soon as practical.

Last year's comments reflected the commitments of many stakeholders to viable competitive wholesale and retail electricity markets in the Commonwealth of Virginia, and urged the Commission to facilitate the process towards fully competitive retail and wholesale electricity markets by completing its review of the applications then pending for the integration of incumbent electric utilities with a Regional Transmission Organization ("RTO").<sup>1</sup> The comments also called for a re-commitment from stakeholders to strive for the successful development of competitive markets in Virginia, based upon the firm belief that continued restructuring is in the best interests of the consumers in the Commonwealth.

---

<sup>1</sup> The Code of Virginia, §§ 56-577, and 56-579, refers to RTOs as "regional transmission entities". These terms may be used interchangeably.

The retail companies identified herein appreciate this additional opportunity to elaborate on those principles from their unique perspectives as potential retail competitors of Virginia's incumbent electric utilities.

The following companies have participated in the development of these comments:

- Constellation NewEnergy, Inc.,
- Direct Energy Services, LLC
- Strategic Energy, LLC

These companies (hereinafter the "Competitive Stakeholders") are united in their belief that the development of effective competition in wholesale and retail electricity markets in Virginia is in the public interest. Moreover, because they focus their businesses on the development of (and participation in) competitive wholesale and retail markets, they offer a unique perspective of the status of competition in Virginia to date, and they have several recommendations for the development of effectively competitive wholesale and retail markets in Virginia.

Pursuant to Va. Code § 56-596 B of the Virginia Electric Utility Restructuring Act, Va. Code Title 56, Chapter 23 (as amended, the "Restructuring Act" or "Act"), the SCC is charged with reporting to the EURC and to the Governor on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition in the Commonwealth as soon as practical. The Commission's report is to include any recommendations of actions to be taken by the General Assembly, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities that the Commission considers to be in the public interest. *Id.* Such recommendations shall include actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites. *Id.*

In your March 17, 2005 letter to stakeholders ("March 17 Letter"), you state (p.2)

Because of the current status of utility membership with PJM, pending dockets before the Commission, and the continued lack of competitive activity in Virginia, we are not asking any specific questions at this time. Rather, we invite and encourage anyone to take this opportunity to submit in writing any commentary regarding national, regional, or Virginia restructuring efforts, policies, activities, or events. We ask that you consider the topics detailed in the statute and provide any recommendations or thoughts you may have regarding them, whether positive or negative.

Consistent with your invitation and applicable law, the Competitive Stakeholders offer the following comments and recommendations to assist the SCC in developing a comprehensive review of ideas that may be considered to facilitate effective competition in Virginia.

## **I. COMMENTS ON THE STATUS OF THE DEVELOPMENT OF REGIONAL COMPETITIVE MARKETS.**

A key concern expressed by many stakeholders last year was the lack of progress towards fully competitive retail and wholesale electricity markets as a result of the delayed integration of incumbent electric utilities into an RTO. The comments also called for a re-commitment from stakeholders to strive for the successful development of competitive markets in Virginia, based upon the firm belief that continued restructuring is in the best interests of the consumers in the Commonwealth.

With the May 1, 2005 integration of Virginia Electric and Power Company d/b/a Dominion Virginia Power (“DVP”) into PJM, a key milestone was reached in the development of effectively competitive wholesale and retail electricity markets in Virginia. Along with DVP, Appalachian Power Company, Potomac Edison Company, and Delmarva Electric & Power Company are now part of PJM’s larger competitive regional energy markets.

While there has not been enough time to gauge the impact on retail competition in Virginia resulting from the participation of these Virginia investor-owned utilities in PJM’s competitive markets, experience is showing that regional competitive retail energy markets are developing in the larger PJM region, especially in those areas that have emerged from the transition period to competition. The degree of success in developing competitive retail electricity markets is largely dependent upon the degree to which the retail markets have addressed the following four areas:

1. Access to competitive, transparent regional wholesale markets, such as those administered by PJM;
2. Costs are properly allocated, so that monopoly services (distribution and transmission services) reflect costs, and do not provide a hidden subsidy to the incumbent’s competitive generation service;
3. Default rates reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided; and
4. Minimum stay requirements and exit fees are avoided, and are replaced by market-responsive pricing mechanisms.

As examples, Maryland has addressed all these critical elements for large customers, and competition is taking hold. According to the latest information from the Maryland Public Service Commission, almost 65% of large Commercial and Industrial (“C&I”) customers are taking service from competitive suppliers, along with 22.5% of Mid C&I, 3.4% of Small C&I, and 2% of residential customers.<sup>2</sup> This competitive activity represents over 2.1 million distribution service accounts, 51, 257 customers, 3250 MW of Demand (peak load obligation), 12,602 MW of total MW Peak Load, and 25.8% of peak load obligation served by competitive suppliers.<sup>3</sup>

The District of Columbia is making progress on all of these elements. Figures for March 2005 show that 11,462 retail customers (5.6%) and 5523 non-residential customers (20.8%) have switched to

---

<sup>2</sup> Source: MD PSC website, Month Ending March 2005: <http://www.psc.state.md.us/psc/electric/enrollmentrpt.htm>.

<sup>3</sup> *Id.*

competitive suppliers,<sup>4</sup> representing in the aggregate 1,381 MW of customer demand (60.5%)<sup>5</sup> and 484,619 MWH (57%) of customer energy usage.<sup>6</sup> However, competition is frozen due to an unexpected order from the District of Columbia Public Service Commission that locked in customers for 12 months to Standard Offer Service. Market participants, however, are united in removing this last barrier, and hope changes will be made in the near future.

In Pennsylvania, Duquesne Light Company has moved into the post-transition period. As of April 1, 2005, 134,609 (22.9%) of its customers are being served by alternative suppliers, representing 1,742.9 MW (42.4 %) of customer load.<sup>7</sup> Other Pennsylvania utilities will be transitioning to market rates through 2011.

In all of these instances, the regulators have moved forward with addressing the need to properly establish default rates that are truly reflective of market pricing.

## **II. IDENTIFICATION AND FURTHER DISCUSSION OF KEY PRINCIPLES AND RECOMMENDATIONS FOR THE DEVELOPMENT OF EFFECTIVE COMPETITION IN THE COMMONWEALTH OF VIRGINIA.**

Notwithstanding the progress in other states, it is unreasonable to expect any significant retail competition to develop in Virginia until several important transition period policies are changed that have erected real barriers to competition. The remaining barriers include items 2, 3, and 4 above:

2. Costs are properly allocated at the end of the stranded cost recovery period (July 1, 2007), so that monopoly services (distribution and transmission services) reflect current costs and load growth, and do not provide a hidden subsidy to the incumbent's competitive generation service;
3. Default rates reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided; and
4. Minimum stay requirements and exit fees are avoided, and are replaced by market-responsive pricing mechanisms.

In addition, the Commission needs to be in a position to re-examine and adjust the allocation of retail supply costs to the supply rates (billing & collection, customer service, account management and other administrative, regulatory and legal costs), so that when the wires charge transition period ends, a more level playing field is created. The present policy is akin to a retail gasoline station (Competitive Service Providers) attempting to compete against a wholesale gasoline terminal (the incumbent electric utility). In addition, it is critical that for retail competition to take hold, the monopoly distribution company not receive a subsidy from competitors by having rates that do not properly reflect costs.

---

<sup>4</sup> Source: DC PSC website, Month ending March 2005:

[http://www.dcpsc.org/pdf\\_files/customerchoice/electric/electric\\_sumstats\\_no\\_cons.pdf](http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_no_cons.pdf)

<sup>5</sup> *Id.*, [http://www.dcpsc.org/pdf\\_files/customerchoice/electric/electric\\_sumstats\\_cons\\_dmnd.pdf](http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_cons_dmnd.pdf)

<sup>6</sup> *Id.*, [http://www.dcpsc.org/pdf\\_files/customerchoice/electric/electric\\_sumstats\\_cust\\_energyuse.pdf](http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_cust_energyuse.pdf)

<sup>7</sup> *Id.*

The new exemption programs mandated by Chapter 827 of the 2004 Acts of Assembly (“Senate Bill 651”) placed an initial limit on the amount of load [1,000 megawatts (“MW”) or eight percent (8%) of a utility’s prior year Virginia adjusted peak-load] that could participate in the wires charge exemption program. *See* Va. Code §56-283 E 4.

The original version of Senate Bill 651 as endorsed by the EURC would have allowed all customers the opportunity to purchase electric energy from Competitive Service Providers without paying the wires charge, as long as they were willing to accept market-based pricing if they returned to their utility for generation service. This limitation is fundamentally at odds with the premise of open competition, because it unfairly limits the number of customers that would be eligible to make this choice. It also reduces the likelihood that competitors will be interested in participating in Virginia’s retail electricity markets, thus placing increased pressure on default service programs.

To date, the exemption programs have yet to be implemented, so they have produced nothing in the way of customer switching or savings. Every passing day reduces the value of these programs. As a means of stimulating the market, the Commission’s next consideration of wires charges should encompass the remaining 18 months of the original capped rate/ wires charge period (i.e., from January 1, 2006 through July 1, 2007), so that customers and suppliers may reasonably evaluate whether to participate in Virginia’s retail electricity markets.

Because a wires charge may be applicable for some or all of the period from January 1, 2006 through July 1, 2007, the General Assembly’s consideration of potential modifications to the Act in the next legislative session should include an expansion of the exemption programs to all customers that wish to participate. Delaying any potential review of expanding the participation beyond 1,000 MW to 18 months after implementation, and periodically thereafter, perpetuates barriers to CSP entry and consumer participation.

The 1,000 MW limit is insufficient to attract widespread and meaningful retail competition to Virginia, notwithstanding RTO developments in Virginia, given current market conditions and the remaining period during which Virginia’s public utilities are permitted to impose wires charges.

DVP and Virginia’s other investor owned electric utilities are not imposing a wires charge for 2005. Accordingly, current retail electric rates in Virginia represent the current “price to beat” for CSPs and consumers alike. For CSPs that wish to serve residential customers, 40,000 residential customers (approximately 150 MW of load) represents a minimum critical mass, while a group of 100,000 residential customers (approximately 370 MW of load) represents a preferable tranche size for marketers interested in the residential market. Current market conditions suggest that these levels of customer participation may not produce sufficient economies of scale to encourage meaningful CSP entry and savings for consumers. Increasing the amount of load above 1,000 MW will place less pressure on default service, and may allow the economy of scale to encourage multiple marketers to enter the market and provide service to customers, notwithstanding razor-thin margins.

While the Competitive Stakeholders support all efforts to encourage customer participation in competitive retail electricity markets, Virginia’s consumers should be assured of being able to return to capped rates rather than market-based rates at any time capped rates are in place.

Many residential customers and businesses will be reluctant to participate if they give up the right to return to capped rates through 2010 in exchange for a limited opportunity (at most, the period January 1, 2006 to July 1, 2007) to avoid a wires charge. Accordingly, the Competitive Stakeholders recommend that all customers have equal access to the same default service applicable to the customer's class, independent of whether or not customers choose to avail themselves of competitive market opportunities.

### **III. CONCLUSION.**

The Competitive Stakeholders appreciate the opportunity to comment upon these issues related to the development of effective competition in Virginia as soon as practical. The Commission should be encouraged to draw on the experiences in other states in developing competitive options for all customers, including those receiving default service.

The Competitive Stakeholders offer their assistance to help design and promote well-developed, effectively competitive retail electric markets in Virginia, which have been envisioned by the General Assembly since 1999. The Competitive Stakeholders encourage the Commission and the General Assembly to use these recommendations to concentrate stakeholder attention and comments on the goal of facilitating effective competition in the Commonwealth as soon as practical.

Very truly yours,

A handwritten signature in black ink, appearing to read "Thomas B. Nicholson", with a stylized flourish at the end.

Thomas B. Nicholson

TBN/tn